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TAGS: [ENRG](#) [EINV](#) [ECON](#) [EC](#)
SUBJECT: A NEW ELECTRICITY REFORM LAW IN THE CONSTITUENT
ASSEMBLY

REF: A. 06 QUITO 2218
[1](#)B. 06 QUITO 1735
[1](#)C. 07 QUITO 955

Classified By: DCM Jefferson Brown, Reasons 1.4 (b&d)

[1](#)1. (C) Summary: Ecuador's Constituent Assembly is considering a GOE proposal to reform Ecuador's dysfunctional electricity sector and gain greater control of this "strategic sector," and might pass an electricity mandate soon. The proposal would consolidate public/private generators, distributors, and the national dispatcher into a single government-controlled company (private generators would remain independent). End Summary.

[1](#)2. (C) The Constituent Assembly (CA) is currently considering a GOE proposal to reform Ecuador's dysfunctional electricity sector once again (the last electricity reform law was passed in 2006 but few of its provisions were fully implemented, ref A). Ecuador's electric sector suffers from a serious lack of investment, a complicated ownership structure and revenue sharing process that is nontransparent and subject to manipulation, overstaffed and poorly run distributors that are unable to collect from clients, and a "tariff deficit" between what the government mandates customers must pay and the actual costs of electricity (ref B). Drawing from Electricity Minister Mosquera's reform plan we heard about last year (ref C), the GOE proposal would consolidate public/private generators, distributors, and the national dispatcher into a single monolithic company under Electricity Ministry control. The main impetus is to improve efficiency, eliminate corruption, and exercise economies of scale.

GOE PROPOSAL

[1](#)3. (C) Electricity Under Secretary for Policy Pablo Cisneros explained the GOE proposal to econoff. The government (which owns a 70% or greater share of each of the 19 distributors in Ecuador) would pay municipalities for their portion of the distributors, and take over ownership. If the municipalities refuse, the government would simply exercise control over the majority of each company. The same would apply to public-private generators. The spot market would still exist, but private companies would have an incentive to sign long term contracts at fixed prices because the huge supply of electricity under a well-run single company would mean minimal demand for the spot market, he claimed. Payment for private generators would be guaranteed.

[1](#)4. (C) The proposal would set a single electricity rate for

the whole country, which Cisneros said would be sustainable because of lower costs under the new, efficient operation. Managers from well-run companies would form an "administration unit" to oversee operations in less efficient offices. A big issue is how to equalize salaries between well-paid Quito employees and lower-paid employees in other areas, Cisneros noted. In addition to that personnel issue, numerous employees would need to be laid off, which could result in huge expenses for severance pay under new labor rules. When the old electricity company INETEL cut staff, Cisneros recalled, some employees were reportedly given severance pay of \$70,000.

15. (U) The single electricity rate would be set at 8.7 cents/kilowatt hour (kwh) beginning in 2009. Currently, electricity costs differ based on location. Distributors with larger numbers of clients to cover fixed costs such as those in Quito and Guayaquil can offer lower prices for electricity than distributors in other parts of the country. For example, according to CONELEC, Ecuador's electricity regulator, in Quito and Guayaquil electricity costs only 7 cents/kwh (in contrast, it costs 17 cents/kwh in Bolivar). The new single electricity rate is actually higher than what Quito and Guayaquil currently charge and prices could go up for their users under the new plan, which could be politically difficult. One option under discussion is maintaining a small subsidy for the two distributors in these two cities.

ELECTRIC SECTOR REACTIONS

16. (C) According to Rafael Drouet, electricity consultant and member of the board of Cenace, Ecuador's independent electricity dispatcher, Cenace board members consider the

proposal "ridiculous." Of the 19 distributors only 3 or 4 are efficient, but more importantly, putting the dispatcher under Ministry control could put political pressure on Cenace to dispatch to certain distributors over others (Cenace's board met with Minister Mosquera to push for maintaining Cenace's independence; they hope they were successful but are not certain). Drouet believes public/private generators and distributors will reject Ministry efforts to consolidate them and doesn't see how the initiative would be enforced. Efficient distributors such as the one in Quito have already come out publicly against the GOE proposal, fearing they will be dragged down by inefficient distributors if consolidated into a single company.

17. (C) US-owned generator Machala Power is not very concerned about the proposed new law at the moment, as it hopes for a final settlement in its outstanding investment dispute with the GOE very soon. General Manager Tomich believes Machala will then have leverage (based on its proposed investments) to negotiate a satisfactory long-term contract, although he is a little nervous about pricing with only one buyer (currently Machala sells all of its electricity in the spot market where prices are highest).

MANDATE EASIER THAN A LAW?

18. (C) Following the meeting with Cenace, the Ministry decided to introduce a mandate that would allow the GOE to make changes to the sector immediately, rather than waiting for the backlog of laws in the CA to subside. Mandates are law-like instruments that follow a more expedited process through the Assembly than laws; they are typically shorter and broader than laws, but are only valid during the term of the Assembly. Under Secretary Cisneros noted that the mandate would exist until a final law is passed (probably not for several months). He expects the mandate to be finalized in mid-June and believes it will pass the Assembly easily, as it is too vague to be controversial.

COMMENT:

19. (C) The current electricity system in Ecuador is highly non-transparent, with the regulator deciding how to parse out insufficient funds collected to various generators. In practice, this distribution is often discretionary. The system definitely needs change. However, a "one size fits all" approach is likely not the best way to price electricity, particularly when large cost differences exist between large cities like Quito and smaller towns. Given the local political power of the current distributors and the complicated structure of the electric sector, it is unclear if the GOE would be able to enforce a mandate or law of this nature. In some areas, where company heads treat the companies as their own private empires and jobs are political rewards, the GOE might face real opposition from management and employees.

Jewell